

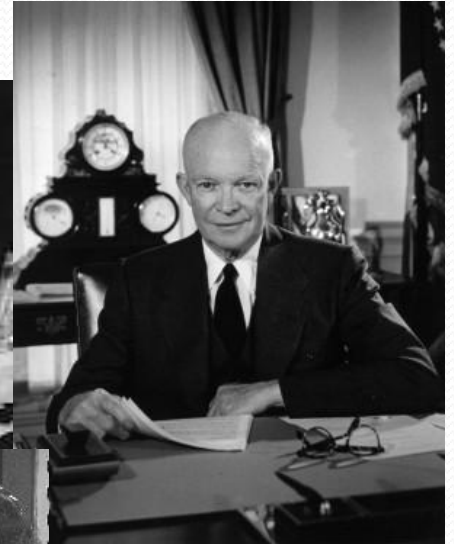
Rulemaking, Directives, and the Department of Revenue

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Secretary's Authority

- Since 1955, the General Statutes have recognized two separate levels of guidance from the Secretary
 - Rules under G.S. 105-262
 - Interpretations under G.S. 105-264



Secretary's Authority

- G.S. 105-262. Rules
 - “The Secretary of Revenue may adopt rules... G.S. 150B-1 and Article 2A of Chapter 150B of the General Statutes set out the procedure for the adoption of rules.”



Secretary's Authority

- G.S. 105-264. Effect of Secretary's interpretation of revenue laws
 - “It is the duty of the Secretary to interpret all laws administered by the Secretary. The Secretary's interpretation of the law shall be consistent with the applicable rules. An interpretation by the Secretary is *prima facie* correct. When the Secretary interprets a law by adopting a rule or publishing a bulletin or directive on the law, the interpretation is a protection to the officers and taxpayers affected by the interpretation, and taxpayers are entitled to rely upon the interpretation. If the Secretary changes an interpretation, a taxpayer who relied on it before it was changed is not liable for any penalty or additional assessment on any tax that accrued before the interpretation was changed and was not paid by reason of reliance upon the interpretation.” [emphasis added]
 - “This section does not prevent the Secretary from changing an interpretation, and it does not prevent a change in an interpretation from applying on and after the effective date of the change.”

Secretary's Authority – Caselaw

- “This section gives the Secretary of Revenue the power to construe the Revenue Act of 1929, codified as this Subchapter, and such construction will be given due consideration by the courts, although it is not controlling.” *Valentine v. Gill*, 223 N.C. 296 (1943)
- “The construction given a taxing statute by the Secretary of Revenue will be given consideration by the courts though not controlling.” *Charlotte Coca-Cola Bottling Co. v. Shaw*, 232 N.C. 307 (1950)
- “If there should be a conflict between the interpretation placed upon any of the provisions of the Revenue Act by the Secretary of Revenue and the interpretation of the courts, the interpretation or construction by the latter will prevail.” *Campbell v. Currie*, 251 N.C. 329 (1959)

Secretary's Authority – Definition of a Rule

- G.S. 150B-2(8a)
 - Rule does not include “nonbinding interpretative statements within the delegated authority of an agency that merely define, interpret, or explain the meaning of a statute or rule.”
- Case law makes it clear that the Secretary's interpretations are not controlling (or binding) on the courts, even though they are afforded great weight
- Statutes make it clear that interpretations are not binding on the Secretary prospectively and may be changed at his discretion
- Statutes state that interpretations may be relied upon and offer protection to a taxpayer, but do not state that they are binding
- As such, Secretary's interpretations under G.S. 105-264 are nonbinding and therefore not a rule

Secretary's Authority – Recent Legislative History

- 2008
 - Report to the Revenue Laws Study Committee on Department's efforts to inform taxpayers of "revised interpretations"
- 2010
 - Notice for revised interpretations
 - Fair Tax Penalties – rule v. directive
- 2011
 - Regulatory Reform Act of 2011

Practical Impacts

- Nothing requires the Secretary to issue directives or adopt rules
 - The directives provide guidance on how the Secretary interprets the underlying law
 - The Secretary could forgo issuing guidance and merely apply the law
- Adopting rules takes much longer than issuing bulletins or directives
 - Example – Changes to taxation of food in 2003
 - Law enacted June 30, 2003
 - Changes took effect July 15, 2003
- Directives and bulletins provide needed guidance to many taxpayers who simply want direction
 - Particularly important for small businesses
 - Particularly important with respect to sales and use taxes

Timeline for Department of Revenue Rules

- Before publishing a rule, Secretary must request OSBM prepare a fiscal note if there is substantial economic impact, OSBM has up to 90 days to respond – G.S. 105-262
- Publish proposed rule
- Accept public comment for at least 60 days – G.S. 150B-21.2(f)
- Take no final action for at least 60 days if there is a sub. econ. impact – G.S. 105-262
- Adopt rule
- Submit adopted rule to Rules Review Commission within 30 days of adoption – G.S. 150B-21.2(g)
- Review by RRC
 - Depends on the date of submission, but generally the RRC has 40 to 70 days to take first action – G.S. 150B-21.9(b)
 - May be extended another 70 days – G.S. 150B-21.13
 - Commission may call a public hearing when it extends period for review (notice of which must be given in the Register) and must make a decision within 70 days after the date of the public hearing – G.S. 150B-21.14
- Rule becomes effective first day of the month following the month the rule is approved, unless the RRC receives written objections from 10 or more people requesting legislative review
 - Rule cannot become effective until 31st legislative day of next regular session of G.A.
 - If a bill to disapprove the rule is filed, rule cannot become effective until an unfavorable action is taken on the bill or the General Assembly adjourns without ratifying bill

Timeline for Department of Revenue Rules - Example

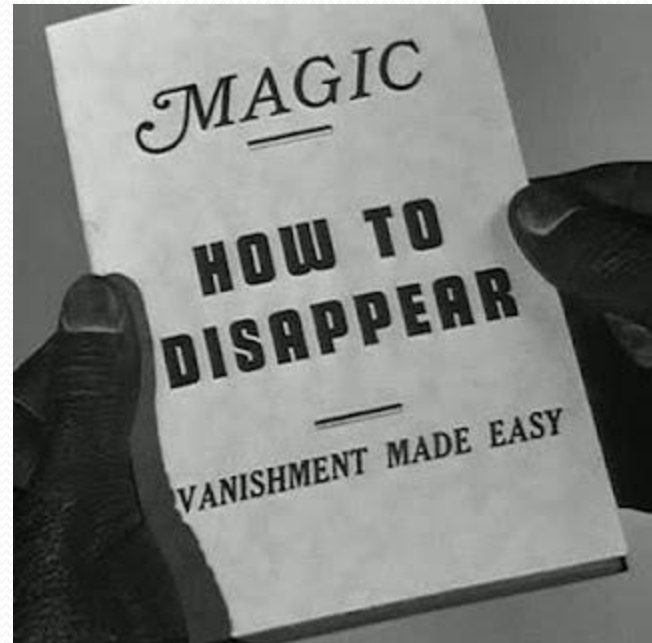
- **Potential** timeline, if Department had adopted a rule with respect to combinations and adjustments
 - Law effective 9/15/11
 - Assume Secretary had a proposed rule ready and immediately requested fiscal note
 - Fiscal note ready and Secretary publishes proposed rule - 12/14/11
 - Secretary accepts public comment, adopts rule and submits rule to RRC - 2/13/12
 - RRC must take first action (accept, reject or extend time) - 4/2/12
 - RRC extends time for review by an additional 70 days - 6/11/12
 - On 6/5/12, RRC calls for a hearing to be held
 - Notice of hearing is published in Register 6/15/12 with a hearing on 7/2/12
 - RRC approves rule 9/10/12, but 10 or more people have objected
 - Bill to disapprove rule filed during first 31 legislative days of 2013 regular session
 - No action is taken on that bill and legislature adjourns 7/1/13
 - Rule becomes effective 7/1/13
 - **21½ months between the effective date of the statute and the effective date of the rule**
 - Taxpayers have no certainty during that time period
- This timeline is one scenario, could be lengthened or shortened based on the timeliness of actions by the Department and others – but a likely effective date would still be the date of adjournment of the 2013 Regular Session
- What actually happened
 - **Department published a directive on November 16, 2011 – 2 months after the statute was enacted**

Practical Impacts - Timeline

- Two complicating factors
 - Does the rule result in substantial estimated additional costs?
 - If so, rule could not be adopted until 7/1/12 under S 22
 - Potential for pushing the timeline out to 2014
 - Is the rule expressly authorized by federal or State law?
 - If not, rule may not be adopted under G.S. 150B-19.1, as enacted by S 781
 - Does “express” mean “explicit or definitive”?
 - If so, G.S. 105-262 gives the Secretary explicit general authority to adopt rules and rule may be adopted
 - Does “express” mean “specific or particular”?
 - If so, nothing in H 619 or S 580 specifically authorizes rules on this issue and Secretary may not adopt rule

Practical Impacts

- Much of the existing guidance from the Department comes in the form of bulletins or directives
- If formal rulemaking is required of the Department, what happens to this existing guidance?



Conclusions

- The issuance of interpretations in the form of directives or bulletins instead of through the formal rulemaking process is authorized and appropriate
- The use of directives and bulletins allows the Department to provide timely guidance to taxpayers on its interpretation of the revenue laws
- The impact on both current and future guidance from the Department of requiring the Department to go through the formal rulemaking process is unclear